

## Internal Revenue Service

## Department of the Treasury

Number: **200243023**

Washington, D.C. 20224

Release Date: 10/25/2002

Index Numbers: 115.00-00; 7701.00-00

Person to Contact:

Telephone Number:

Refer Reply To:

**CC:PSI:3-PLR-111622-01**

Date:

**July 23, 2002**

### **Legend**

Board =

LLC =

State =

D1 =

D2 =

Dear :

We received your letter dated February 5, 2001, and subsequent correspondence and submissions, requesting a ruling on behalf of LLC that the income of LLC is excluded from gross income under §115(1) of the Internal Revenue Code ("Code"). Alternatively, your letter requests a ruling that LLC is a disregarded entity under §7701 of the Code. This letter responds to your request.

### **FACTS**

LLC was formed on D1 as a State limited liability company. LLC's sole member is Board (an agency of State), recognized as an organization described in §501(c)(3). Board's income is excluded from gross income under §115(1). Board's purpose is to provide professional investment management of various trusts established under the laws of State. Board has broad authority under State law to manage and invest, sell,

PLR-111622-01

reinvest and collect income and rents, to employ outside counsel and contractors, and to acquire, manage and sell real estate. The Attorney General of State has determined that Board has the authority under State law to authorize the formation of LLC and to purchase real estate and other equities through LLC.

LLC's organizing documents provide that LLC's purpose is to acquire, hold and eventually sell certain real property, currently owned by Board. Board, LLC's sole member, entered into an operating agreement with respect to LLC with a real estate management company. LLC's organizing documents provide that any person may become a substitute member by acquiring an interest from Board. The organizing documents provide that upon dissolution the cash and other assets of LLC, after payment of expenses, will be distributed to the member.

Effective D2, LLC amended its organizing documents to provide that LLC's membership is limited to a state, a political subdivision of a state, or an entity whose income is excluded from gross income under §115(1), as long as Board is a member. LLC's operating agreement was also amended effective D2, to provide that the agreement was between LLC and Board.

### **LAW AND ANALYSIS**

Section 115(1) provides that gross income does not include income derived from the exercise of an essential governmental function and accruing to a state or any political subdivision thereof.

Rev. Rul. 71-589, 1971-2 C.B. 94, provides that the income from property held in trust by a city, which was to be used by the city for certain charitable purposes, is not subject to federal income tax. Although Rev. Rul. 71-589 does not explicitly so state, its holding is based on a determination that the income in question was derived from the exercise of an essential governmental function and accrued to a political subdivision within the meaning of §115(1). Rev. Rul. 71-589 specifically mentions several types of functions that the trust might perform, such as support of a hospital, schools, maintenance of a park, or other purposes ordinarily recognized as a municipal function.

Rev. Rul. 77-261, 1977-2 C.B. 45, holds that income from a fund established under a written declaration of trust by a state, for the temporary investment of positive cash balances of a state and its political subdivisions, is excludible from gross income under §115(1). Rev. Rul. 77-261 reasons that the investment of positive cash balances by a state or political subdivision thereof, to receive some yield on the funds until needed to meet expenses, is a necessary incident of the power of the state or political subdivision to collect taxes and raise revenue. Rev. Rul. 77-261 points out that Congress did not desire in any way to restrict a state's participation in enterprises which

PLR-111622-01

might be useful in carrying out those projects desirable from the standpoint of the state government which, on a broad consideration of the question, may be the function of the sovereign to conduct.

Rev. Rul. 90-74, 1990-2 C.B. 34, concerns an organization that is formed, operated and funded by political subdivisions to pool their casualty risks arising from their obligations concerning public liability, workers' compensation, or employees' health. Rev. Rul. 90-74 states that the income of the organization is excluded from gross income under §115(1) if private interests do not participate in the organization or benefit more than incidentally from the organization. In Rev. Rul. 90-74, the benefit to the employees of the political subdivisions was excepted as incidental. Furthermore, upon dissolution, the organization will distribute its assets to its members. Therefore, the income of the organization accrues to a political subdivision within the meaning of §115(1).

LLC plans to engage in investment activities that Board is authorized under State law to engage in directly. LLC's sole member, Board, formed LLC to purchase real estate and other equities. Therefore, based on Rev. Rul. 71-589, Rev. Rul. 77-261 and Rev. Rul. 90-74, the income of LLC is derived from an essential governmental function.

Membership in LLC is limited to a state, a political subdivision of a state, or an entity whose income is excluded from gross income under §115(1), as long as Board is a member. Further, upon dissolution, LLC's assets, less expenses, will go to the member. The amended operating agreement is between LLC and the Board. Effective D2, the date of the amendments to LLC's organizing documents, LLC's income is excluded under the §115(1) accrual test. However, if Board is no longer a member of LLC and LLC has a member that is not a state, a political subdivision of a state or an entity whose income is excluded under §115(1), LLC will not satisfy the §115(1) accrual test, and LLC's gross income will not be excluded from gross income under §115(1).

### **CONCLUSION**

Based on the information submitted and representations made, we conclude that the income of LLC is excluded from gross income under §115(1) effective only on and after D2, the date LLC's organizing documents were amended to satisfy the §115(1) accrual test. For purposes of §115(1), an organization's income is excludible from gross income from the date the necessary changes are made to an organization's organizing documents and do not relate back to D1, the date of LLC's organization. However, if Board is no longer a member of LLC and LLC has a member that is not a state, a political subdivision of a state, or an entity whose income is excluded under §115(1), LLC will no longer satisfy the §115(1) accrual test.

PLR-111622-01

Based on Rev. Rul. 78-316, 1978-2 C.B. 304, LLC, classified as a corporation subject to tax under subtitle A of the Code, is required to file a federal income tax return under §6012(a)(2).

Except as specifically set forth above, we express or imply no opinion concerning the federal tax consequences of the facts described above under any other provision of the Code. More specifically, we express or imply no opinion regarding whether LLC is a disregarded entity under §7701.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this letter must be attached to any income tax return to which it is relevant.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer's representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

/s/

Christine E. Ellison  
Chief, Branch 3  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosures (2):

Copy of this letter

Copy for § 6110 purposes

cc: